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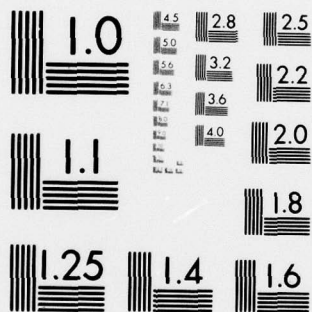
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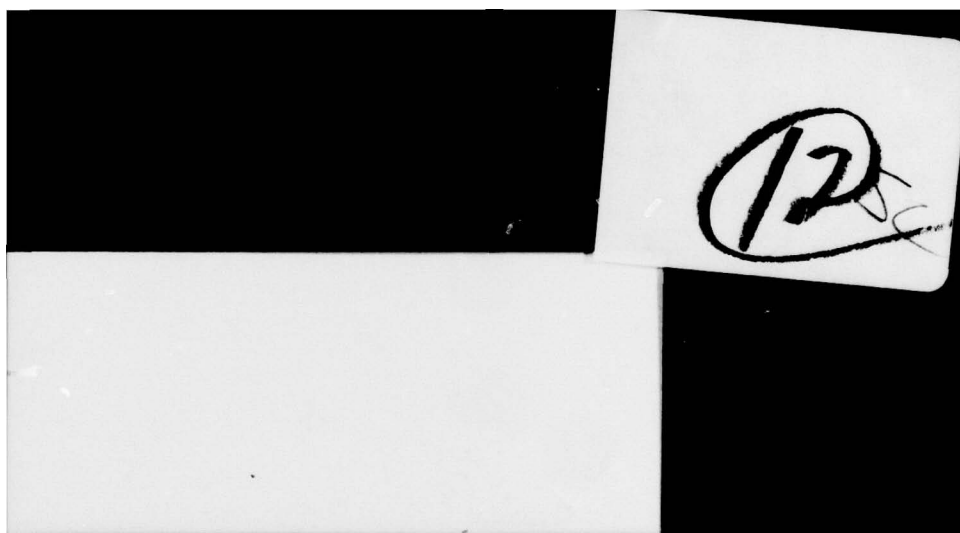
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EXECUTIVE SUMMARY

On March 31, 1978, the Treasury Department issued Chapter 8000 of the Treasury Fiscal Requirements Manual (I-TFRM 6-8000), entitled "Cash Management." Chapter 8000 provides guidelines for establishing effective cash management practices within the Federal Government to reduce Federal debt requirements and interest carrying costs. The purpose of this study was to determine whether Department of Defense (DoD) payment practices comply with the Treasury guidelines and, if necessary, to recommend any changes to the Defense Acquisition Regulation (DAR) payment clauses to promote compliance.

The Treasury guidelines require that payments be made as close as administratively possible to the due date; if no due date is specified, payment is to be made on the 30th day after receipt of the invoice. When discounts are taken, invoices are to be paid on or near the last day of the discount period. Consistent with Treasury guidance, "receipt of invoice" was defined in this study as receipt by the Government official or office designated to receive the invoice, and the term was not restricted to receipt by the Government paying office. In addition, consistent with Treasury guidance, "due dates" as set forth in invoices or contracts must be specific enough to provide a basis for considering the time value of money. If such specificity is lacking, the invoice or contract is considered as not containing a due date.

The DAR payment clauses reviewed in this study require payments to be made pursuant to provisions such as "upon submission of proper invoices," "promptly after receipt of the invoice" or "as soon as practicable." There are conflicting interpretations of the clauses within the DoD as to whether the clauses meet the Treasury's specificity of due date requirement. The Treasury Department has taken the position that the clauses do not contain the necessary language to specify payment due dates and are inconsistent

with the Treasury's cash management regulations, specifically, I TFRM 6-8040.20, "Timeliness of Disbursements." For purposes of analysis, this study adopted the Treasury interpretation. This means that payments made pursuant to the clauses should comply with the Treasury's "30-day" provision.

Payments covering 2815 invoices, with a dollar value of \$29 million, from 40 payment centers of the Army, Navy, Air Force, and DLA were examined. The invoices were randomly selected from payments made during calendar year 1978. Payments reflecting contractor financing arrangements, such as Government guaranteed loans, advance payments, and progress payments were excluded, since they are designed to provide for contractor working capital needs and should not be subject to normal cash management practices.

The data show that current DoD payment practices do not conform to the Treasury guidelines. Although the average payment time is 29 days, this figure is misleading, because the majority of the invoices are being paid substantially earlier or later than 30 days after receipt. Also, contrary to Treasury requirements, certain types of discounts are not being taken, and when they are, the invoices are not being paid on or near the last day of the discount period.

To promote compliance with the Treasury guidelines, it is recommended that two new clauses, entitled "Timing of Disbursements" and "Discount Terms," be added to the DAR, rather than amending each of the DAR payment clauses.

Timing of Disbursements. All authorized payments will be scheduled for receipt by the payee as close as administratively possible to the due date specified in the applicable invoice, contract, or other agreement. If no due date is specified, the due date will be considered to be on the 30th day following the receipt of the invoice by the activity designated the initial recipient and payment will be scheduled to be made on that date.

Discount Terms. Provided the related goods or services have been received, except as specifically provided by contract or other agreements executed pursuant to law, discounts will be taken when the discount rate is equivalent to, or greater than, 1 percent in 10 days, net 30 days. Lesser discounts, but in no case less than 1/2 percent in 10 days, net 30 days, or equivalent, may be taken. All discounted payments will be scheduled for check issuance on the last day of the discount period.

It is also recommended that DAR Section 2-407 and paragraph 9 of Standard Form 33A be revised to include the Treasury guidelines proscription against taking certain types of discounts.

One benefit of adopting the proposed Timing of Disbursements clause would be a decrease in interest carrying costs for the period between the current payment time and the new 30th day and/or last day of the discount period. Another would be an increase in the number and value of discounts offered by vendors, as vendors will have a greater incentive to offer discounts since they know that non-discount invoices would be paid later.

Conversely, certain disadvantages may offset the benefits. First, there may be an increase in administrative work since extra effort may be required to control suspense files. Second, delaying payments may damage public relations with contractors, especially small and minority businesses. Third, prices of future goods and services may increase as a result of the contractors' need to recover the additional interest carrying expenses. Finally, the 30-day provision will cause the DoD to forego the financial benefits associated with its current practice of making payments beyond 30 days, resulting in additional interest expense for the Government. It should also be noted that contractors could still assure payment before 30 days by specifying due dates or "net" on their invoices. Positive effects of the proposed Discount Terms clause include (1) decreases in interest carrying costs and (2) savings through the acceptance of more favorable discount terms. Offsetting effects include (1) prospects of fewer discounts being offered and (2) the DoD foregoing financial benefits associated with exercising discounts beyond the discount period.

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1. INTRODUCTION

BACKGROUND

On November 14, 1977, President Carter directed his reorganization staff to undertake, in conjunction with the Treasury Department, a comprehensive review of cash management policies and practices throughout the executive branch. The review was to identify opportunities to apply modern cash management techniques to the Federal cash flow in order to reduce Federal debt requirements and interest carrying costs.

Three months later, a General Accounting Office (GAO) report, "The Federal Government's Bill Payment Performance is Good But Should Be Better" (FGMSD-78-16, February 24, 1978), stated that Federal agencies were paying most of their bills in a timely manner; however, in some cases lengthy delays had occurred. Sixty-one percent of the Government's bills and 81 percent of the dollar total were paid within 30 days of the invoice date. Nearly 85 percent of the bills and 98 percent of the dollar total were paid within 60 days. A key finding of the GAO report was that many bills were paid sooner than is commonly expected in commercial practice which resulted in the Government incurring unnecessary interest costs and motivating companies to discontinue offering discounts since they were receiving payment fast enough without them.

Both the GAO report and the President's staff report of March 1978, "Strengthening Federal Cash Management," recommended improving contractual terms and conditions to ensure that bills are paid on time, and not early, unless there are compensating discounts. Shortly thereafter on March 31, 1978, Chapter 8000 of the Treasury Fiscal Requirements Manual (I-TFRM 6-8000) entitled "Cash Management," was issued. This chapter provides guidelines for establishing effective cash management practices within the Federal Government to maximize cash balances available to the Treasury and to avoid unnecessary borrowing.

STUDY OBJECTIVE AND SCOPE

The objective of this study was to recommend standard Defense Acquisition Regulation (DAR) clauses which comply with the new Treasury guidelines, specifically the requirements of Section 8040 which covers disbursements. The scope of the study included:

- Examining current Department of Defense (DoD) payment practices
- Reviewing current DAR payment clauses to discern if change is necessary
- Estimating the general impact on cash flow and capital requirements for industry and Government resulting from any necessary changes
- Recommending draft standard DAR payment clauses.

At the request of our project officer, contractor financing payments such as Government guaranteed loans, advance payments and progress payments were excluded, because they are designed to provide for contractors' working capital needs, and are not subject to normal cash management practices.

2. PAYMENT PROCEDURES

SUMMARY OF TREASURY GUIDELINES

Section 8040 states that payments will be made so that receipt by the payee will be as close as administratively possible to the due date. "Due date" means the date specified in the invoice, contract, or other agreement. If no due date is specified, payment is to be made on the 30th day from receipt of invoice.

Treasury officials construe "receipt of invoice" broadly. It means receipt by the Government official (or office) designated to receive the invoice and is not restricted to receipt by the paying office. For example, if a contractor presents an invoice, as required under the terms of the contract, to the Administrative Contracting Officer (ACO) who in turn forwards it to the paying office, "receipt of invoice" takes place at the ACO level. A recent GAO decision supports this position. See United Peoples Laundry, Inc., B-193968, 18 June 1979.

Discounts are required to be taken whenever the discount rate is equivalent to or greater than 1% in 10 days, net 30 days. Lesser discounts, but in no case those offering less than 1/2% in 10 days, net 30 days, may be taken at the Government's discretion. The discounted payments are to be issued on the last day of the discount period.

Payments not made within 30 days of receipt of invoice (excluding payments involving disputed invoices or non-receipt of goods or services) are considered late payments.

The actual language of the relevant provisions of Section 8040 is as follows:

Section 8040—DISBURSEMENTS

8040.10—General. Invoices, bills, statements, or any other documents (hereinafter referred to as "invoices") which are authorized for payment by an agency, including progress and final payments, will be paid when due. Accounting systems will be designed to facilitate an agency's financial responsibilities and ensure the necessary degree of control over the timely payment of invoices and the taking of appropriate discounts.

8040.20—Timeliness of Disbursements. An agency's payment system will be designed to provide for scheduling the issuance and mailing of checks for receipt by the payee as close as administratively possible to the due date as specified in the invoice, contract, or other agreement. If no due date is specified, the due date will be considered to be on the thirtieth (30) day from receipt of the invoice and payment will be scheduled to be made on that date. If the goods or services are not received by the 15th day before the due date of an invoice, payment will be made no later than 15 days from the receipt of goods and service, but not prior to the due date. Payments will not be made on invoices prior to the receipt of the related goods and services by an agency or its duly authorized agent, except as specifically provided by contract or other agreements executed pursuant to law.

8040.30—Cash Discounts. Agency payment systems will incorporate procedures which will automatically take advantage of cash discounts as a matter of routine and eliminate any need for special handling. Such discounts will be taken when the discount rate is equivalent to, or greater than, 1% in 10 days, net 30 days. Lesser discounts, but in no case less than 1/2% in 10 days, net 30 days or equivalent, may be taken by an agency after its determination that such discounts would be cost effective, considering its own operations. All discounted payments will be scheduled for check issuance on the last day of the discount period. However, payments will not be made to achieve discounts unless the related goods or services have been received except as specifically provided by contract or other agreements executed pursuant to law.

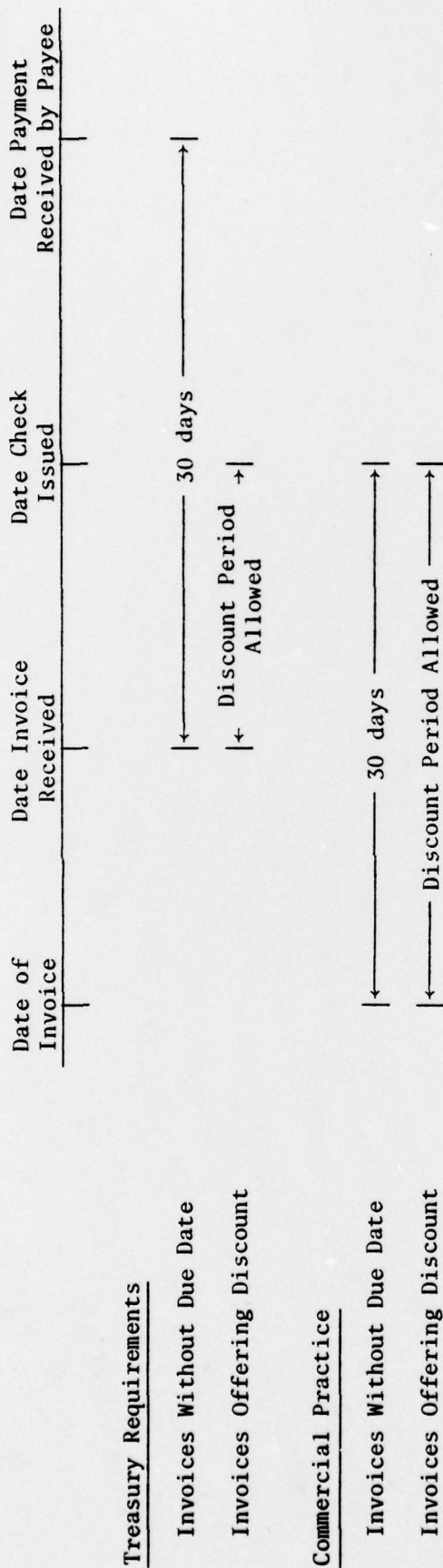
8040.50—Late Payments. Agencies will make every effort to make payments of Government obligations in a timely manner. With the exception of payments involving disputed invoices or late or non-receipt of goods and services, payments not accomplished within thirty days of receipt of an invoice will be considered as late payments, which will be reviewed by agencies and reported to the Treasury (see I TFRM 6-8080.40).

COMPARISON OF COMMERCIAL PRACTICES WITH TREASURY GUIDELINES

A review of several DoD contractors' payment practices reveals that the usual commercial practice is to use the date of the invoice to determine the beginning of a payment period, rather than the date of receipt. In the absence of a due date, the commercial standard is to pay within 30 days of the date of the invoice. These findings are consistent with those of the GAO report mentioned earlier. Figure 1 compares commercial payment practices with the requirements of the Treasury guidelines.

FIGURE 1

COMPARISON OF TREASURY GUIDELINE REQUIREMENTS WITH
COMMERCIAL PAYMENT PRACTICES



DoD PAYMENT PROCEDURES

Although variations exist among the Services, the following general description of DoD payment procedures can be made. Once the contractor has completed work on the item(s) specified in the contract, he must forward a DD Form 250 to the cognizant Contract Administration Office within 24 hours of shipment. If the contract specifies source acceptance, the DD Form 250 (provided that it has been signed by the local Quality Assurance Representative) will act as both the shipping and acceptance document, thereby expediting payment. Payment will be somewhat delayed in those instances where inspection and acceptance of the item at its destination have been specified in the contract.

When the Contract Administration Office receives the DD Form 250, it notifies the purchasing office or inventory control point, whichever is designated, that the shipment has been made. Once the material has been either shipped to the destination or accepted at the source, the contractor may submit his invoice to the paying office. The paying office then reviews the invoice to ensure its validity. If errors are detected or if additional information is required, either from the contractor or other Government installations, delays can occur. Payment is based on a match of the DD Form(s) 250, the contractor's invoice(s), and the contractual term(s) and clause(s) specified in the contract(s). Some contractors, such as Grumman, Lockheed, Sikorsky, and LTV, are able to expedite this entire payment cycle because Government disbursing offices are located in their contracting plants.

Invoices are usually processed at paying offices in the following order: (1) those offering discounts for payment within a specified period, (2) those having specified payment dates, and (3) those not having specified payment dates.

SUMMARY OF DAR PAYMENT CLAUSES

Under the DAR, unless otherwise specified in an agreement executed in accordance with law, payments are not to be made prior to the receipt of goods and services. The

DAR payment clauses referred to in this study require payments to be made pursuant to provisions such as "upon submission of the proper invoices or vouchers," "promptly after receipt of the invoice," or "as soon as practicable." (Excerpts from pertinent DAR clauses are presented at the end of this section.)

The clauses are ambiguous enough to allow different interpretations of whether they specify when payment is actually due. This ambiguity makes it difficult to determine whether current DoD paying practices are in compliance with the new Treasury Guidelines. If a DAR payment clause is interpreted as not having a specific due date, the 30-day provision of Section 8040 applies. However, if a clause is interpreted as containing a specific due date, payment is required on that date, and the 30-day provision does not apply.

A review of the decisions of the Court of Claims, GAO Comptroller General, and the Board of Contract Appeals disclosed no case which addressed due date interpretations for any of these DAR payment clauses. The issue also appears to have never been raised in a DAR council meeting.

In an October 6, 1978 memorandum to the Assistant Secretaries of the Military Departments and the Directors of the Defense Agencies, the DoD Comptroller (Management Systems) viewed the payment clauses as specifying payment due dates. However, in a subsequent memorandum, dated November 7, 1978, to the Deputy Under Secretary of Defense Research and Engineering (Acquisition Policy), the Comptroller appeared to have modified this position by stating a need to specify due dates clearly, since continued use of the DAR payment clauses could be interpreted as circumventing the intent of Section 8040.20 of the Treasury guidelines. Conflicting interpretations of the October 6 memorandum, particularly with regard to fast payment procedures, caused the Comptroller to issue another memorandum on March 13, 1979 to the Assistant Secretaries of the Services and the Directors of the Defense Agencies. This memorandum stated that if the invoice contained a specific due date, payment would be made in

accordance with such terms; if no terms were specified, payment would be made in accordance with "current payment procedures."

The Treasury Department informed LMI, in writing, that the payment clauses in question do not contain the necessary language to specify payment due dates and are inconsistent with the objectives of the Treasury's cash management regulations, specifically, I TFRM 6-8040.20, "Timeliness of Disbursements." Consequently, payments made pursuant to these clauses are subject to the 30-day provision of Section 8040.20. LMI accepted the Treasury's position and based its evaluation of payments made pursuant to these DAR clauses on compliance with the 30-day requirement.

Excerpts from the relevant DAR payment clauses follow.

Fixed-Price Supply Contracts

DAR 7-103.7 Payments (1958 Jan) - "The Contractor shall be paid, upon the submission of proper invoices or vouchers...."

Cost Reimbursement Supply Contracts

DAR 7-203.4 Allowable Cost, Fixed Fee, and Payment (1978 Sep) - "Promptly after receipt of each invoice or voucher and statement of cost, the Government shall...make payment thereon as approved by the Contracting Officer."
"On receipt and approval of the...completion invoice...the Government shall promptly pay to the Contractor any balance of allowable cost...."

Fixed-Price R&D Contracts

DAR 7-302.2 Payments (1959 Jun) - "The Contractor shall be paid, upon submission of proper invoices or vouchers...."

Cost Reimbursement R&D Contracts

DAR 7-402.3 Allowable Cost, Fee, and Payment (1978 Sep) - Incorporates DAR 7-203.4.

Personal Services Contracts

DAR 7-503.2 Payments (1958 Jan) - "Payments for the services performed by the Contractor...shall be made...upon the submission by the Contractor of proper invoices or time statements...."

Fixed-Price Construction Contracts

DAR 7-602.7 Payments to Contractor (1976 Mar) - "Upon completion and acceptance of all work, the amount due the Contractor under this contract shall be paid upon the presentation of a properly executed voucher...."

Cost Reimbursement Construction Contracts

DAR 7-605.5 Allowable Cost, Fixed Fee, and Payments (1978 Aug) - "Promptly after receipt of each invoice or voucher and statement of cost, the Government shall...make payment thereon as approved by the Contracting Officer."

Fixed-Price Architect and Engineering Contracts

DAR 7-607.14 Method of Payment (1976 Oct) - "(P)ayment upon properly executed vouchers shall be made to the Architect-Engineer as soon as practicable...."

Consolidated Facilities Contracts

DAR 7-702.10 Allowable Cost and Payment (1978 Aug) - "Promptly after receipt of each invoice or voucher and statement of cost, the Government shall...make payment thereof as approved by the Contracting Officer."

Facilities Acquisition Contracts

DAR 7-703.9 Allowable Cost and Payment (1978 Aug) - "Upon receipt and approval of the invoice or voucher...the Government shall promptly pay to the Contractor any balance of allowable cost."

Facilities Use Contracts

DAR 7-704.3 Allowable Cost and Payment (1965 Jul) - "For the performance of any work...under this contract...the Government shall pay the Contractor the cost thereof...."

Letter Contracts

DAR 7-802.4 Payments of Allowable Costs Prior to Definitization of Contract (1972 May) - "Promptly after receipt of each invoice or voucher and statement of cost, the Government shall...make payment thereon as approved by the Contracting Officer."

Time and Material Contracts

DAR 7-901.6 Payments (1972 May) - "Upon receipt and approval of the...completion voucher...the Government shall as promptly as may be practicable pay any balance due and owing the Contractor."

Rental of Motor Vehicles Contracts

DAR 7-1501.1 Rental Payments (1967 Apr) - "The Government shall pay...upon the submission of proper invoices and vouchers."

Communication Service Contracts

DAR 7-1702.10 Payment—Common Carrier (1971 Apr) - "The Government shall pay the Contractor, in arrears, upon submission of invoices for services and facilities furnished...."

Fixed-Price Service Contracts

DAR 7-1902.5 Payments (No date) - Incorporates DAR 7-103.7.

Cost Reimbursement Service Contracts

DAR 7-1909.4 Allowable Cost, Fee, and Payment (No date) - Incorporates DAR 7-203.4.

In addition to the above clauses, there are two others concerning discounts, which are set forth below. In contrast to the Treasury guidelines, neither of these clauses prescribes a particular discount amount as a condition for acceptance.

Fixed-Price Supply Contracts

DAR 7-103.14 Discounts (1968 Jun) - "In connection with any discount offered, time will be computed from date of delivery of the supplies to carrier when

acceptance is at point of origin or from date of delivery at destination or port of embarkation when delivery and acceptance are at either of these points, or from the date the correct invoice or voucher is received in the office specified by the Government, if the latter is later than date of delivery. Payment is deemed to be made for the purpose of earning the discount on the date of mailing of the Government check."

Fixed-Price Service Contracts

DAR 7-1902.11 Discounts (1971 Nov) - "In connection with any discount offered, time will be computed from the date of completion of performance of the services or from the date correct invoice or voucher is received in the office specified by the Government, if the latter is later than date of completion of performance. Payment is deemed to be made for the purpose of earning the discount on the date of mailing of the Government check."

3. REVIEW OF DoD PAYMENT PRACTICES

DATA DESCRIPTION

Payments covering 2815 invoices, with a dollar value of \$29 million, from 40 Service payment centers were examined. The invoices were randomly selected from payments made during calendar year 1978. As noted earlier, all payments reflecting contractor financing arrangements (e.g., progress payments) were excluded, as well as payments processed under fast payment procedures. Table 1 shows the distribution of the invoices and dollar value by Service.

TABLE 1
DISTRIBUTION OF INVOICES AND DOLLAR VALUES

<u>Service</u>	<u>Number of Invoices</u>	<u>Percent</u>	<u>\$ Amount</u>	<u>Percent</u>
ARMY	716	25.4	5,874,026	20.2
NAVY	755	26.8	4,208,492	14.5
AIR FORCE	682	24.2	6,773,881	23.3
DLA	662	23.5	12,242,483	42.1
TOTAL	2815	100.0	29,098,882	100.0

Contracts often require that a contractor submit an invoice to a Government office other than the paying office. Thus, there is often a lapse of time between when an invoice is submitted and when it is received and recorded by the paying office. Unfortunately, invoices are not logged in as they are received at offices other than paying offices. However, since contractors normally submit invoices concurrently with the delivery of goods or services, it is reasonable to assume that the date of invoice, as recorded on the invoice itself, is a good proxy for date of receipt by the Government. It would be unreasonable to use the date the invoice was received by the paying office as a

proxy for receipt by the Government, since the data show a 14-day difference between invoice dates and date received by the paying office. Thus, in the following analyses, date of invoice was used as a proxy for date of receipt by the Government.

AVERAGE PAYMENT TIMES

Table 2 shows the average payment times for each of the Services. Three averages are presented. The first, 33 days, is the average for all the invoices in the sample. The second, 36 days, excludes all invoices in which discounts were offered and taken by the Government. As expected, exclusion of these invoices increases the average paying time, since most discount periods are 30 days or less. The third, 29 days, excludes invoices with discounts taken, as well as invoices with actual payment times over 90-days. Over-90-day invoices are excluded because they usually involve contractor disputes and the extended payment times do not properly reflect normal paying office practices. Being subject to less distortions, the 29-day average is the better reflection of DoD paying practices. Assuming two days for mail time, the average paying time becomes 31 days. This would seem to indicate that DoD is in close compliance with the Treasury guidelines, which require payments to be received by the contractor 30 days after date of receipt by the Government. However, as the analysis in the next section reveals, the 31-day average is misleading.

TABLE 2

AVERAGE PAYMENT TIMES BY SERVICE

<u>Service</u>	<u>Total Sample (days)</u>	<u>Total Sample Less Discounts Taken (days)</u>	<u>Total Sample Less Discounts Taken and Over 90 Day Payments (days)</u>
ARMY	35	37	28
NAVY	42	44	36
AIR FORCE	28	30	25
DLA	25	28	24
TOTAL	33*	36*	29*

*Weighted Average

TIMELINESS OF PAYMENTS

Table 3 elaborates on DoD's payment practices. It shows that 57.6% of the sample invoices and 71.8% of the dollar value were paid within 30 days of the invoice date. Excluding over-90-day invoices as abnormal, 36.8% of the invoices and 24.5% of the dollar value were paid after 30 days of the invoice date. Thus, according to the Treasury guidelines, DoD is paying many invoices too early (i.e., before 30 days less mail time) and almost 37% of them too late (i.e., beyond 30 days).

The average paying time of the invoices paid within 30 days is 18 days. Allowing two days for mail time, this means that these invoices, with a dollar value of \$18,250,818, are being paid 10 days too early. Assuming that the Government borrowed the money at a 10% annual interest rate compounded daily, the cost to the Government in unnecessary interest expense for 10 days is \$50,064. By way of contrast, the data show that the average paying time for invoices paid between 30 and 90 days is 45 days. Adding two days for mail time, this means that these invoices, with a dollar value of \$6,228,639, are being paid 47 days too late. This means that the Government is saving \$29,074 in additional interest charges.

Assuming the contractors borrow the money to cover working capital needs due to late payments at a 12% annual interest rate compounded daily, their cost would be \$96,976. The sophisticated contractor would pass this extra expense on to the Government in the form of higher prices in future transactions.

Thus, although the 31-day average connotes compliance with the Treasury guidelines, Table 3 reveals that the average is misleading because most invoices are not being paid on or near 30 days from receipt. The early payments create unnecessary interest expenses for the Government. However, these interest expenses may be offset, in whole or in part, by the interest saved by paying invoices late, since the Government is not now required to pay contractors interest on late payments. This saving, in turn, would be offset by the higher prices the contractors would charge.

TABLE 3
TIMELINESS OF PAYMENTS
(Excluding Discounts Taken)

Days* Elapsed Until Payment	ARMY			NAVY			AIR FORCE			DLA			TOTAL				
	# Invoices (%)	\$ Amount (%)	# Invoices (%)	\$ Amount (%)	# Invoices (%)	\$ Amount (%)	# Invoices (%)	\$ Amount (%)	# Invoices (%)	\$ Amount (%)	# Invoices (%)	\$ Amount (%)	Cumulative Percent	\$ Amount (%)	Cumulative Percent	Average Time (days)	
0-15	151 (25.0)	4,053,086 (74.4)	26 (3.9)	2,559,306 (62.2)	203 (35.7)	4,041,874 (65.8)	154 (37.8)	1,269,361 (13.0)	534 (23.8)	11,923,627 (46.9)	23.8	46.9				10	
16-30	205 (34.0)	670,376 (12.3)	259 (39.0)	376,203 (9.1)	160 (28.1)	1,222,933 (19.9)	135 (33.2)	4,057,679 (41.7)	759 (33.8)	6,327,191 (24.9)	57.6	71.8				23	
31-45	110 (18.2)	353,289 (6.5)	192 (28.9)	455,008 (11.1)	124 (21.8)	522,717 (8.5)	65 (16.0)	3,136,092 (32.3)	491 (21.9)	4,467,106 (17.6)	79.5	89.4				37	
46-90	101 (16.8)	341,805 (6.3)	142 (21.4)	573,724 (13.9)	56 (9.8)	114,612 (1.9)	36 (8.9)	731,392 (7.5)	335 (14.9)	1,761,533 (6.9)	94.4	96.3				59	
Over 90	36 (6.0)	30,912 (0.6)	45 (6.8)	148,805 (3.6)	26 (4.6)	241,830 (3.9)	17 (4.2)	539,783 (5.5)	124 (5.5)	961,330 (3.8)	100.0	100.0				153	
TOTAL**	603 (100.0)	5,449,468 (100.0)	664 (100.0)	4,113,046 (100.0)	569 (100.0)	6,143,966 (100.0)	407 (100.0)	9,734,307 (100.0)	2243 (100.0)	25,440,787 (100.0)							

*Elapsed time between date of invoice and payment.

**Due to rounding, total percents may not equal 100 percent.

Table 3 also indicates that large invoices are paid earlier than small ones. The average invoice size being paid within 30 days is \$14,115, while the average invoice size being paid between 30 and 90 days is \$7,534. However, analysis in the next section shows that this disparity of payment times is not significant.

PAYMENTS BY INVOICE SIZE

Table 4 shows that smaller invoices, those under \$10,000, comprise 87.5% of the sample but account for only 10% of its dollar value. These invoices, generally from small businesses, are being paid only slightly slower than large invoices. When adjustments are made for discounts taken and unduly long payment times, the relative payment times remain unchanged. Thus, size of invoice does not appear to affect its payment time substantially.

DISCOUNTS

The Treasury guidelines state that discounts will be taken if equivalent to or greater than 1% in 10 days, net 30 days, or equivalent, and that no discounts will be taken if less than 1/2% in 10 days, net 30 days, or equivalent. Table 5 shows that 645 discounts were offered and 572 (88.7%) were taken and that DoD, by and large, is taking discounts in accordance with the Treasury guidelines. Of those 572 discounts taken, 51 were taken where the discount offered was less than 1/2% in 10 days, net 30 days, or equivalent, which is contrary to the Treasury guidelines. (However, some of these discounts may have been negotiated under DAR 2-407.3 and taken under DAR 2-407.3(d), which states that the offered discount of the successful bidder shall form a part of the award and will be taken if made within the discount period regardless of the amount of the discount involved.) DoD was offered discounts greater than 1% 519 times and accepted 465 (89.6%). Thus, according to the guidelines, DoD improperly took discounts for only 7.9% of the invoices (51/645) and improperly failed to take discounts for only 8.7% of the invoices (56/645).

TABLE 4
PAYMENT BY INVOICE SIZE

Size of Invoice	Total Sample			Total Sample Less Discounts Taken and Over-90-Day Payments		
	# Invoices (%)	\$ Amount (%)	Average Paying Time* (days)	# Invoices (%)	\$ Amount (%)	Average Paying Time* (days)
\$10,000 or less	2464 (87.5)	2,897,814 (10.0)	34	1853 (87.5)	2,065,101 (8.4)	29
Greater than \$10,000	351 (12.5)	26,201,068 (90.0)	28	266 (12.5)	22,414,356 (91.6)	24
TOTAL	2815 (100.0)	29,098,882 (100.0)	33	2119 (100.0)	24,479,457 (100.0)	29

*Weighted Average

TABLE 5
DISCOUNTS
(TOTAL SAMPLE)

Service	Number of Invoices	Number of Discounts Offered	Number of Discounts Taken (%)	Number of Discounts Taken/Offered Where Discount < 1/2%	Number of Discounts Taken/Offered Where Discount > 1%
ARMY	716	118	113 (95.8)	3/4	106/110
NAVY	755	144	91 (63.2)	0/2	87/130
AIR FORCE	682	115	113 (98.3)	4/5	100/101
DLA	662	268	255 (95.2)	44/48	172/178
TOTAL	2815	645	572 (88.7)	51/59	465/519

The guidelines also state that when discounts are taken, checks will be issued on the last day of the discount period. Figure 2 shows that the Army, as a representative Service, is not satisfying this requirement. The figure shows that few invoices are paid on or near the last day of the discount period. The majority of invoices where discounts are taken are being paid too early. The figure also reveals that, in quite a few cases, the Government is taking discounts beyond the last day of the discount period. This practice is not only technically unlawful, but as a practical matter, discourages contractors from offering discounts in future transactions.

Further insight into the discount paying practices is provided by Figure 3, which shows how fast the invoices are handled once they are received by the paying office. In general, discount invoices are paid in approximately one-half the time allowed for exercising the discount indicating that discounts are being paid too quickly. However, it must be remembered that many discounts are forwarded to the paying office by other Government offices. Thus, since part of the discount period has already elapsed, the paying office may have to expedite the payment process in order to take advantage of the discount.

FIGURE 2
DISCOUNT PERFORMANCE - ARMY

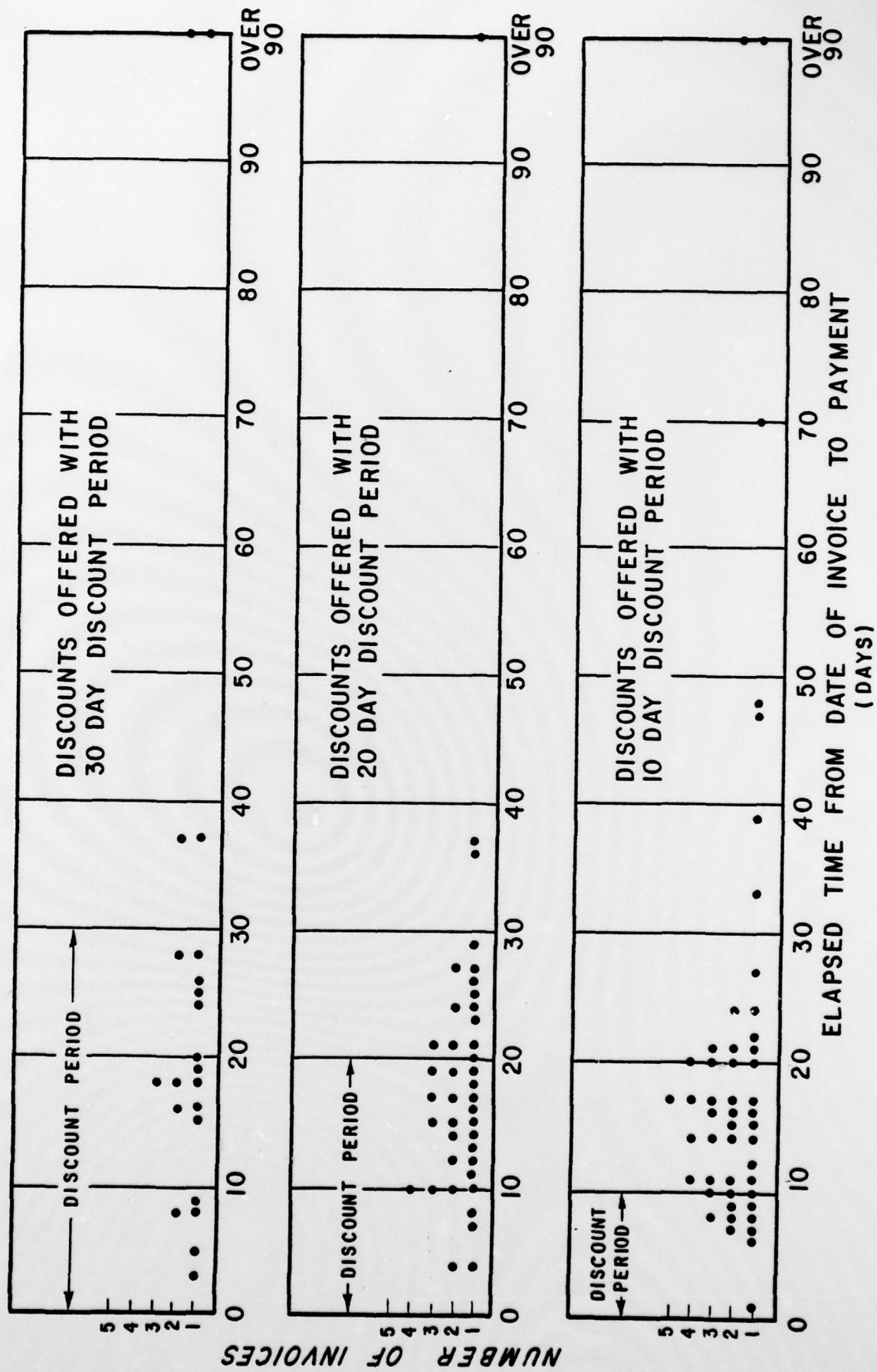
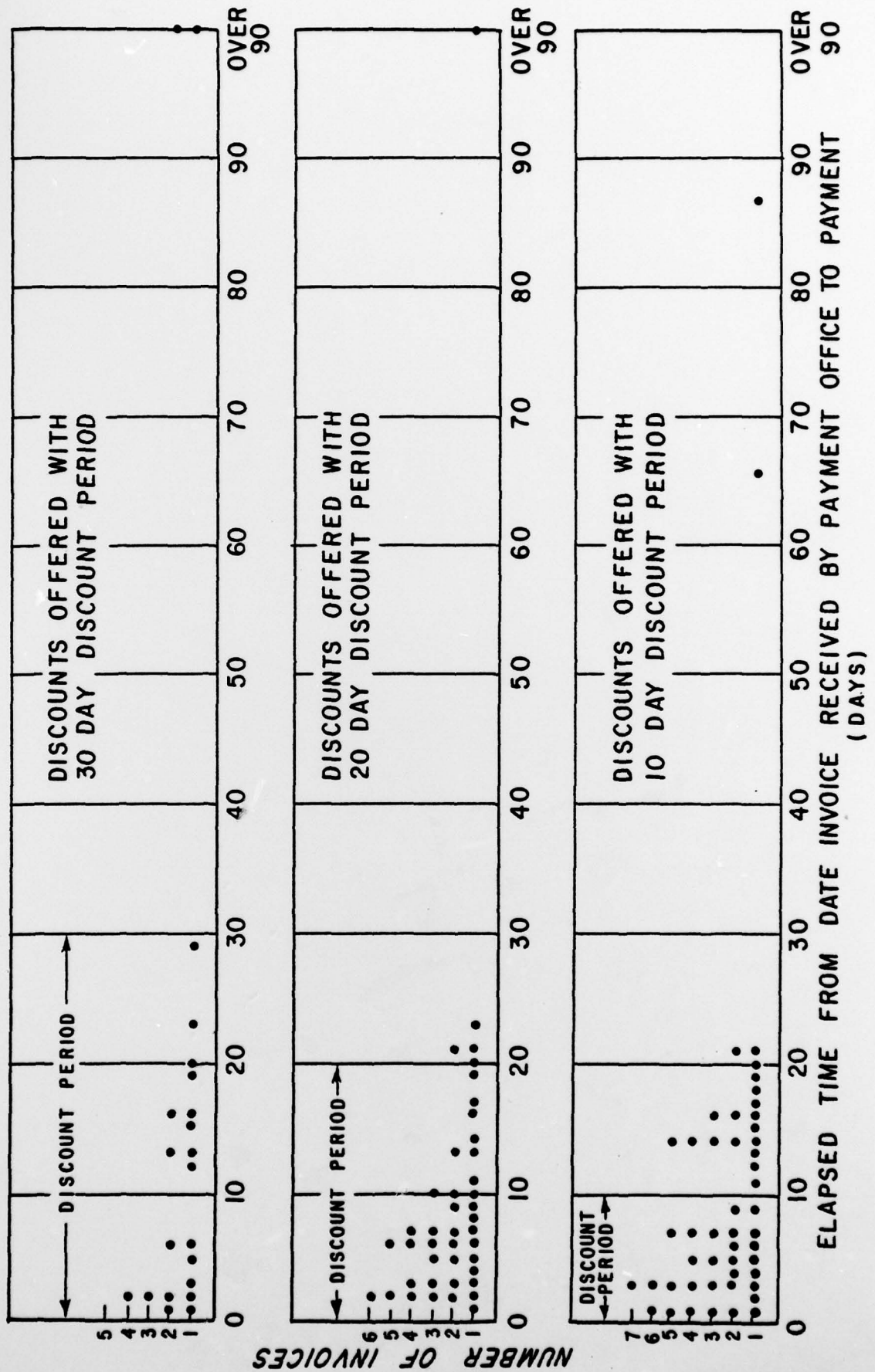


FIGURE 3
DISCOUNT PERFORMANCE - ARMY



4. CONCLUSIONS AND RECOMMENDATIONS

This study adopted the Treasury Department's position that the DAR payment clauses reviewed in this study do not contain specific due dates and therefore are subject to the "30th day" provision of the Treasury guidelines. LMI's review of current DoD payment practices shows that they are not in compliance with this 30-day provision. The average payment time of 29 days is misleading, since the data show that the majority of the invoices are being paid substantially earlier or later than 30 days after receipt of the invoice. This situation calls for adjustments to current DAR payment clauses in order to promote compliance with the Treasury guidelines.

Rather than amending current contract clauses, LMI recommends that a new clause, entitled "Timing of Disbursements," be added to the DAR for mandatory inclusion in all new contracts whenever any of the clauses listed below are used.

<u>Type of Contract</u>	<u>DAR Clause</u>
Fixed-Price Supply	7-103.7
Cost Reimbursement Supply	7-203.4
Fixed-Price R&D	7-302.2
Cost Reimbursement R&D	7-402.3
Personal Services	7-503.2
Fixed-Price Construction	7-602.7
Cost Reimbursement Construction	7-605.5
Fixed Price Architect and Engineering	7-607.14
Consolidated Facilities	7-702.10
Facilities Acquisition	7-703.9
Facilities Use	7-704.3
Letter	7-802.4
Time and Material	7-901.6
Rental of Motor Vehicles	7-1501.1
Communication Service	7-1702.10
Fixed-Price Service	7-1902.5
Cost Reimbursement Service	7-1909.4

The proposed clause does not apply to any type of contract containing fast payment or progress payment clauses. Payments pursuant to those types of clauses should be made in strict conformance with those clauses.

Proposed Disbursement Clause

Timing of Disbursements. All authorized payments will be scheduled for receipt by the payee as close as administratively possible to the due date specified in the applicable invoice, contract, or other agreement. If no due date is specified, the due date will be considered to be on the 30th day following the receipt of the invoice by the activity designated the initial recipient and payment will be scheduled to be made on that date.

The effects of making any adjustment to the current DAR clauses in an effort to promote compliance with the Treasury guidelines include (1) decreases in interest carrying costs for the period between the current payment time and the new 30-day provision; and (2) increases in the number and value of discounts offered, since vendors will know nondiscount invoices will be paid later than invoices offering discounts. Offsetting effects include (1) increases in administrative work; (2) damaging public relations with vendors, especially small and minority businesses; (3) increases in the prices of future goods and services; and (4) increases in interest carrying charges, since late payments (and their associated benefits) will not be allowed.

It also should be noted that an obvious way contractors can assure payment before 30 days is to clearly specify due dates or "net" on their invoices.

Current DoD payment practices regarding discounts are also not in compliance with the Treasury guidelines. Certain types of discounts are not being taken, and those that are, are not being paid on or near the last day of the discount period. To rectify this situation, it is recommended that a new discounts clause entitled "Discount Terms" supplement the current DAR discount clauses (7-103.14 and 7-1902.11).

Proposed Discount Terms Clause

Discount Terms. Provided the related goods or services have been received except as specifically provided by contract or other agreements executed pursuant to law, discounts will be taken when the discount rate is equivalent to, or greater than 1 percent in 10 days, net 30 days. Lesser discounts, but in no case less than 1/2 percent in 10 days, net 30 days, or equivalent, may be taken at the discretion of the Government. All discounted payments will be scheduled for check issuance on the last day of the discount period.

The positive effects of promoting compliance with the discount provisions of the Treasury guidelines are (1) decreases in interest carrying costs; and (2) savings through the acceptance of more favorable discount terms.

Offsetting effects include (1) less discounts being offered; and (2) the DoD foregoing financial benefits associated with exercising discounts beyond the discount period.

It is also recommended that DAR Section 2-407 and paragraph 9 of Standard Form 33A be revised to include the Treasury guidelines proscription against taking certain types of discounts.

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20. ABSTRACT (Continue on reverse side if necessary and identify by block number) This report presents an analysis of whether Department of Defense (DoD) payment practices comply with the Department of the Treasury's cash management regulations. It was found that the Defense Acquisition Regulation (DAR) payment clauses do not contain the necessary language to specify payment due dates and are inconsistent with the Treasury regulations. After reviewing payments covering 2815 invoices, with a dollar value of \$29 million, from 40 payment centers of the Army, Navy, Air Force, and DLA, it was found that DoD (cont'd)		

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20. (cont'd)

payment practices do not conform to the Treasury regulations.

To promote compliance with the Treasury regulations, the study recommends that two new clauses, "Timing of Disbursements" and Discount Terms," be added to the DAR, rather than amending each of the DAR payment clauses.

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